

BALTIMORE COUNTY FISCAL DIGEST

General Fund Revenues & The Economy

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REVENUE HIGHLIGHTS

Preliminary FY 2002 County General Fund revenue totaled \$1,200.7 million, 0.1% (or \$0.9 million) above FY 2001 levels, representing the smallest increase since FY 1992 when total County General Fund revenue fell by 2.3%. Overall, FY 2002 General Fund revenue was \$8.8 million, or 0.7%, below the Adopted Budget estimate. FY 2002 highlights:

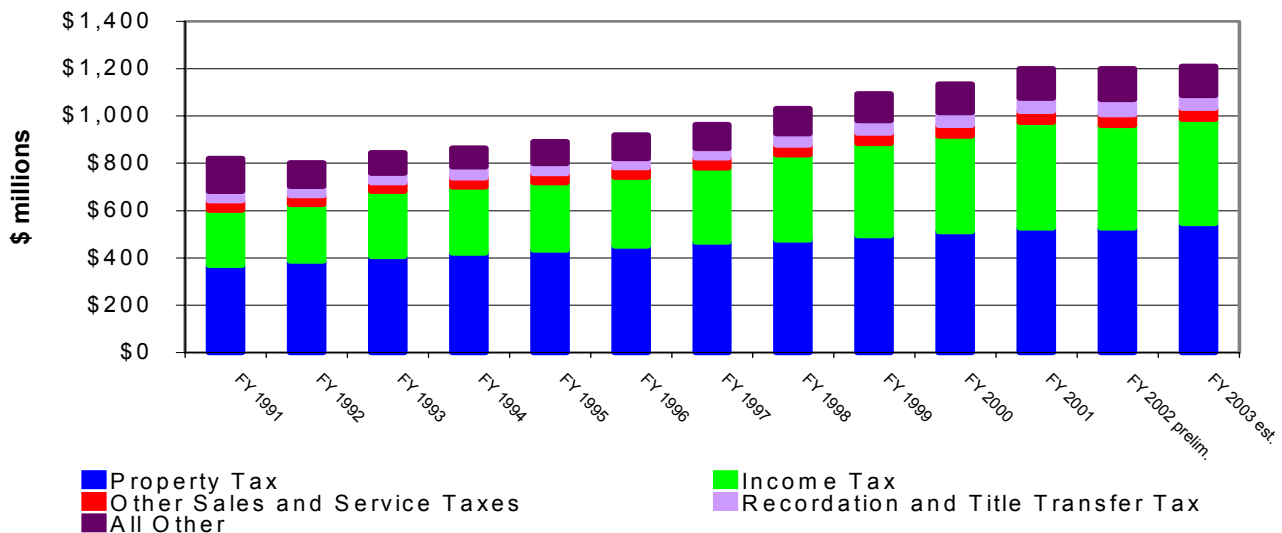
- FY 2002 income tax revenue decreased by \$13.5 million, or 3.0%, and investment income was down by \$8.9 million, or 62.7%, from FY 2001 levels.
- Revenue related to property transfers was up sharply, as was "other" revenue, which in FY 2002 mostly reflected the sale of County-owned property.
- As of June 30, 2002, the County's estimated surplus was \$99.7 million, including \$65.0 million in the Revenue Stabilization Reserve Account.

FY 2003 General Fund revenue is forecast to increase by \$9 million, or 0.7%, to \$1,209.7 million. FY 2003 highlights:

- The County's two largest revenue sources are expected to show gains over the previous fiscal year, with property tax revenue projected to increase by \$18 million or 3.4%, and income tax revenue projected to rise by \$7 million, or 1.7%, over FY 2002 collections.
- In FY 2003, General Fund revenue is projected to exceed expenditures by \$10.5 million, bringing the County's surplus to an estimated \$110.3 million, including \$66.7 million in the Revenue Stabilization Reserve Account.

The U.S. Gross Domestic Product (GDP), the broadest gauge of economic activity, grew at an annualized rate of 1.1% in the second quarter of 2002 – well below expectations. Most economists believe that the expansion is still on track, but a number of economists are raising the possibility of another economic downturn stemming from the lost wealth in the recent stock market slide, only slightly improving corporate profitability, and a weak labor market.

Baltimore County 12-Year Revenue History & FY 2003 Projections



NATIONAL ECONOMIC INDICATORS

The U. S. economy grew at a snail's pace in 2002:Q2 with GDP increasing by only 1.1%.

The weak GDP performance was mostly attributable to a surge in imports, but on the bright side spending on equipment and software increased for the first time in nearly two years.

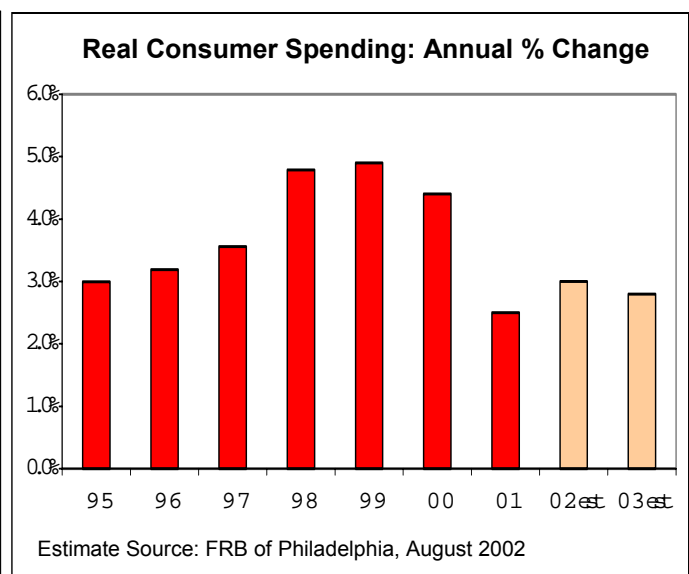
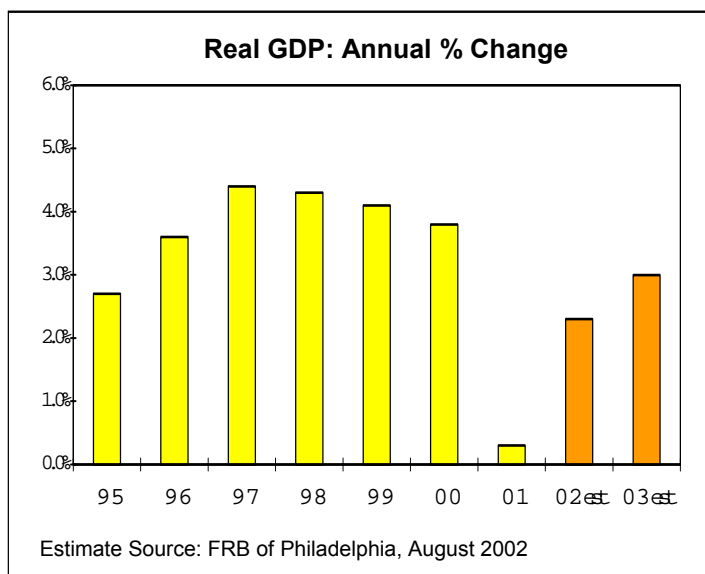
Consumer spending continues, albeit at a slower rate.

Consumer confidence fell again in September for the fourth consecutive month. The pattern in consumer confidence is not inconsistent with economic recovery.

U.S. Gross Domestic Product (GDP) increased by a scant annualized rate of 1.1% in the second quarter of 2002, following an increase of 5.0% in 2002's first quarter. This "preliminary" reading on the strength of the economy in the second quarter was well below the growth rate economists expected; however, these estimates are subject to considerable revision (either up or down). The economy's weak performance mostly reflected surging imports perhaps due to the fear of a longshoremen's strike later this summer or early fall. On a bright note, spending on equipment and software rose for the first time in seven quarters. The GDP report also showed that the 2001 recession was more severe and longer in duration than previously thought. Revised data show that the GDP contracted for three consecutive quarters in 2001 - not one quarter as previously reported. Most economists (including Alan Greenspan) consider the second quarter slowdown in GDP growth an aberration and believe that the economy will show more strength as the year progresses.

Consumer spending, which accounts for slightly more than two-thirds of all U.S. economic activity, increased at an annual rate of 1.9% in the second quarter, significantly slower than in the last two quarters when personal consumption expenditures increased at annual rates of 3.1% (2002: Q1) and 6.0% (2001:Q4). Consumer spending was strongest for services and durable goods, while spending on nondurable goods was flat in the second quarter.

Consumer Confidence fell for the fourth consecutive month in September to its lowest level since November 2001. According to the Conference Board, the private research group that surveys and publishes consumer confidence numbers, "weak labor market conditions continue to erode confidence.....but while consumers are not as positive about current business conditions, they are more optimistic about the outlook than last month." The Conference Board added that historically this trend is commonly evidenced during an economic recovery.



Some short-term interest rates have dropped to levels not seen since 1960.

Further interest rate cuts are possible when the Federal Reserve meets again in early November.

Long-term interest rates have moved down only slightly since the start of the recession in March 2001; however, they are at relatively low levels.

Interest rates, especially short-term rates, have been declining since early 2001 when the Federal Reserve made its first of eleven interest rate cuts that year. The Federal Reserve first lowered the federal funds rate on January 3, 2001 by 50 basis points to 6.0% and made additional cuts in the federal funds rate over the course of 2001 to its current level of 1.75% - near a 41-year low. No additional formal interest rate cuts have been made by the Federal Reserve in 2002, and over the course of 2002, short-term interest rates have been relatively flat and long-term rates have been down slightly.

Further interest rate cuts are possible. At the Federal Open Market Committee (FOMC) meeting on September 24, the FOMC left its policy outlook stance unchanged saying that the "the risks are weighted mainly toward conditions that may generate economic weakness." Two voting members of the FOMC voted in favor of lower interest rates suggesting an inclination toward lower rates in coming months. The FOMC meets again on November 6.

Long-term interest rates have shown little movement compared to short-term interest rates. (While the Federal Reserve can influence short-term interest rates, it has virtually no control over long-term interest rates.) The following table illustrates the recent declines in both long and short term interest rates since the start of the recession in March 2001:

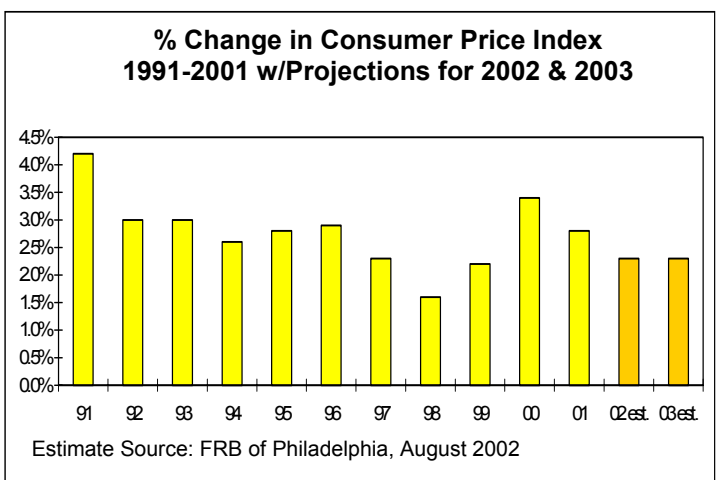
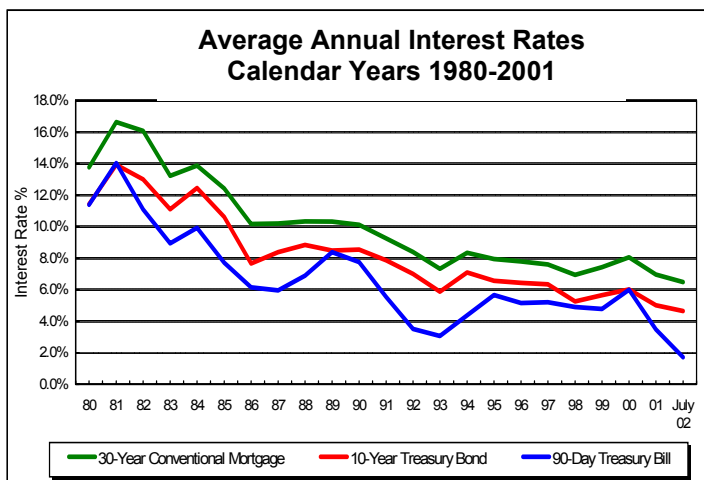
INTEREST RATE DECLINES FROM MARCH 2001 TO AUGUST 2002

	<u>Basis Points*</u>
90-Day Treasury Bills	289
10-Year Treasury Bonds	63
30-Year Conventional Mortgage	79

* a basis point is equal to .01 percentage points.

From July 2001 to July 2002, consumer inflation was 1.5%. Inflation in 2002 and 2003 is forecast to increase by 2.3% in each year.

Inflation, as measured by the Consumer Price Index-All Urban Consumers, over the July 2001 to July 2002 period was 1.5%, well below the recent trend level. Higher medical care and housing costs are the principal culprits driving recent inflation numbers. Current inflation forecasts for 2002 and 2003 (year-over-year annual average) are 2.3% for each year, according to the Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters published in August.



THE LOCAL ECONOMY IN PERSPECTIVE

EMPLOYMENT

County resident employment continues to grow despite a tough labor market.

County jobs contracted by 0.6% over the 2000:Q4 to 2001:Q4 period; however, payrolls showed a smart 5.3% gain.

The County's July unemployment rate was 4.6%, slightly above the State average, but below the national rate.

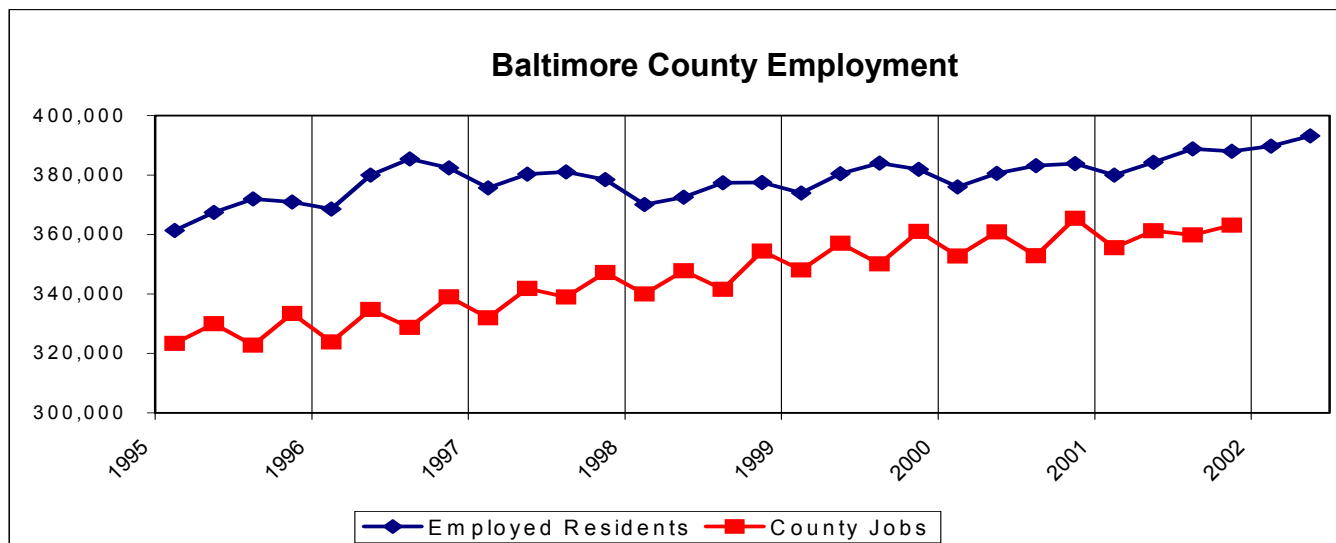
Projected County resident employment growth should support growth in County income tax revenue.

Employment among County residents increased by an estimated 8,860 persons, or by 2.3%, from 2001:Q2 to 2002:Q2. Over the same period, total employment of State residents increased by 2.0%. On a year-over-year basis from July 2001 to July 2002, Baltimore County and State resident employment increased by 2.5% and 2.1%, respectively, while national employment declined by 1.2 million persons or 0.9%.

County jobs data lags resident employment data by several quarters. With the peak job numbers for both the County and State that were reached in 2000:Q4, current comparisons clearly show the impact of the recession. From 2000:Q4 to 2001:Q4, County jobs decreased by 0.6% while payrolls rose by 5.3%. Over the same period, State jobs dropped by 0.1% while payrolls increased by 3.4%. Nationally, the private sector added a disappointing 39,000 jobs in August and since the recession officially began in March 2001, 1.7 million have been cut. For FY 2002–FY 2003, RESI (August 8, 2002) is forecasting that County jobs will increase a scant 0.3%, compared to an increase of 1.0% in FY 2001–FY 2002.

Unemployment among County residents increased by 3,113 persons over the 2001:Q2 to 2002:Q2 period; however, the County's labor force expanded by nearly 12,000 persons over the same period. Additionally, the unemployment rate averaged 5.0% in 2002:Q2, up a little over one-half of a percentage point from 4.4% in 2001:Q2. Within the Baltimore Metropolitan Area (BMA), the County's July unemployment rate of 4.6% tied for second highest rank but remained below the BMA July average of 4.8%, an average that is strongly influenced by Baltimore City's unemployment rate of 7.8%. Statewide in July, the unemployment rate was 4.2%. Nationally, the unemployment rate fell to 5.7% in August.

Income tax revenue is the second largest revenue source for the County and earned income from jobs is the largest source of income tax revenue. Thus, growing County resident employment provides a foundation for the potential expansion of income tax collections and improved County General Fund revenue prospects.



PERSONAL INCOME

Over 1990–2000, national personal income grew faster than Maryland and Baltimore County personal income.

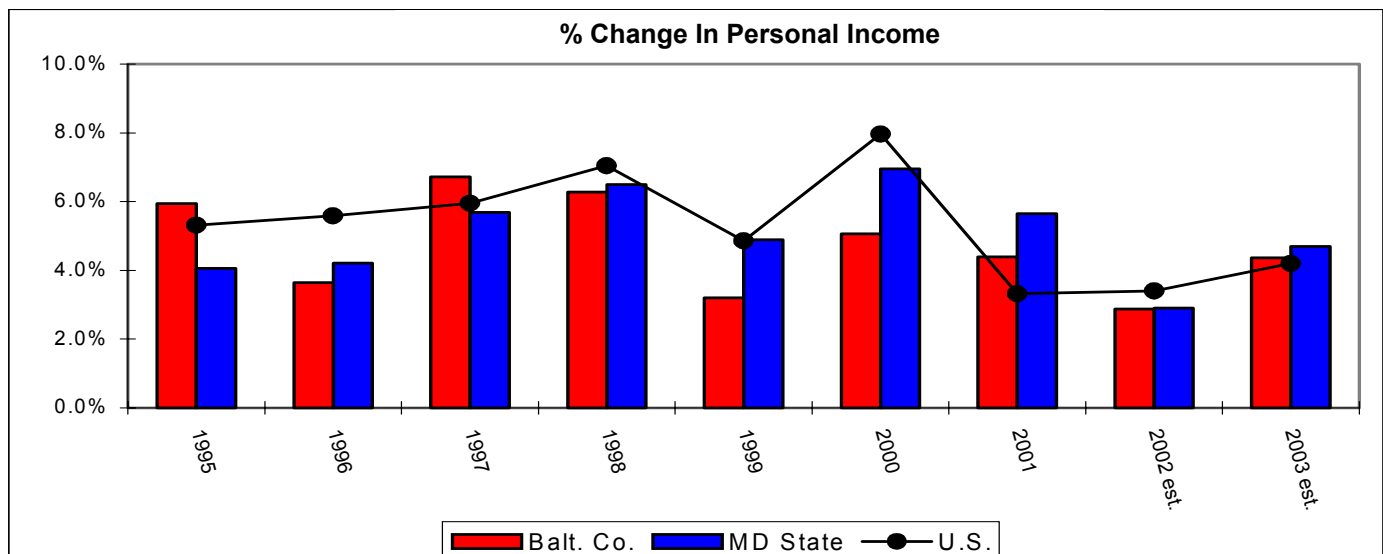
Personal income volatility presents some unique challenges for the County's spending affordability targets.

Personal income forecasts are being revised downward suggesting that the spending affordability guideline would have been set lower if current personal income forecasts were used when the index was constructed.

Over the 1990 to 2000 period, personal income in the U.S., Maryland, and Baltimore County advanced by 71.5%, 61.0%, and 54.3%, respectively. Interestingly, over that ten-year period, in no year did the growth rate in Maryland personal income exceed the growth of personal income at the national level (in 1999, Maryland and the U.S. both experienced personal income growth of 4.9%). Personal income growth in Baltimore County exceeded the U.S. personal income growth rate in two out of the ten years – in 1995 and 1997. However, personal income growth in Maryland finally exceeded the national rate in 2001 (Baltimore County 2001 data are not yet available).

Changes in personal income, as in most statistical series, can be fairly volatile. Data show that over the 1990 to 2000 period, personal income volatility was the lowest at the State (Maryland) level, followed by the national level, and highest at the County (Baltimore) level. County personal income volatility presents some unique challenges given that County spending affordability is targeted to changes in personal income.

The County Spending Affordability Committee adopted a spending affordability index of 1.0451 (4.51%) based on an average of six FY 2003 personal income forecasts for the State of Maryland and the estimated ratio of Baltimore County to State personal income growth. However, since December 2001 when those forecasts were prepared, personal income forecasts for FY 2003 have been falling at most forecasting firms, as too has the ratio of County to State personal income growth projections. From December 2001 to August 2002, personal income growth projections from RESI were lowered by 1.21 percentage points for Maryland and by 1.56 percentage points for Baltimore County. Assuming no other forecasts were lowered, that adjustment alone would have lowered the FY 2003 County spending affordability guideline by \$6.4 million or 0.6%. The current FY 2003 RESI personal income forecasts for Maryland and Baltimore County are 3.8% and 3.5%, respectively. Such a slowdown in personal income growth implies softer income tax collections.



EXISTING HOME SALES ACTIVITY

In FY 2002, existing home sales in Baltimore County increased by 9.4% and recordation and title transfer tax revenue increased by 13.5% over FY 2001 levels.

The housing market will likely slow in FY 2003 due to a low inventory of homes for sale.

2002:Q2 pending existing home sales were 2% less than in the comparable 2001 period.

Lower mortgage interest rates have more than offset rising home prices in the County.

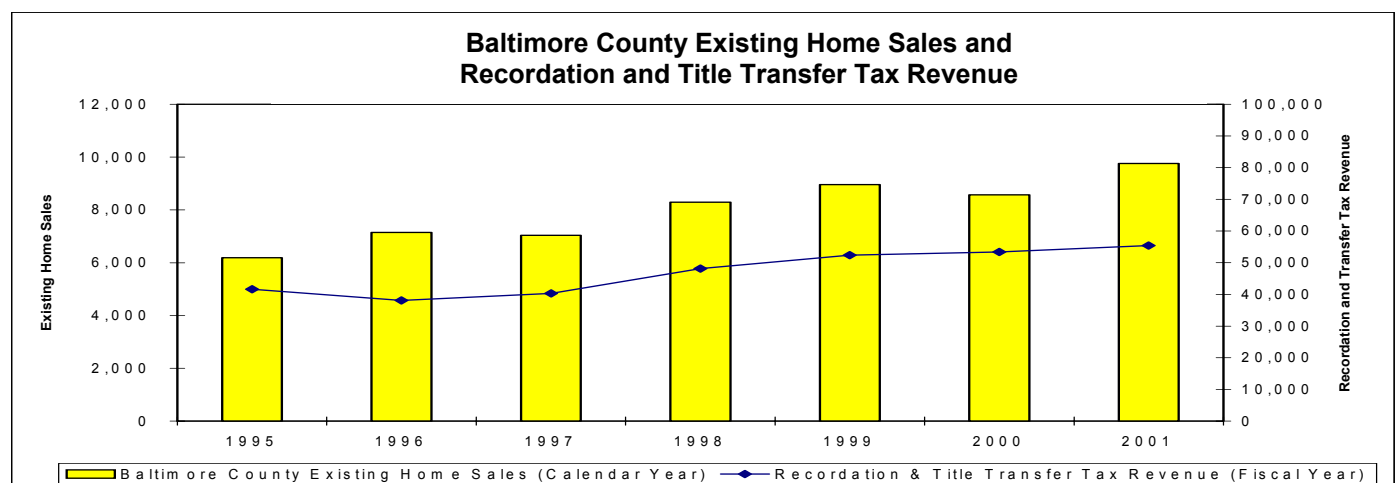
Property-related transfer tax revenue is projected to decline in FY 2003.

Existing home sales in Baltimore County in FY 2002 (July 2001 through June 2002) totaled 10,034 units, up an impressive 9.4% over the FY 2001 level of 9,173 units. FY 2002 recordation and title transfer taxes were up 13.5% on a year-over-year basis. In the second quarter of 2002, existing home sales in the County were virtually flat compared to the 2001 period (2,843 units versus 2,827 units, respectively). However, in May and June 2002, County existing home sales were slightly below the comparable 2001 sales level, the first time that existing home sales in the County declined over a comparable monthly period since December 2000. A continued slowing in existing home sales is expected in FY 2003, reflecting an active inventory of homes for sale that was down by 34.1% over the June 2001–June 2002 period.

Pending existing home sales in the April–June 2002 quarter (the final quarter in FY 2002) were down 2.0% from the comparable 2001 quarter. May and June 2002 pending existing home sales were less than in the comparable 2001 period, while April 2002 pending sales were greater. The slowing in pending sales again reflects the low level of existing homes for sale in the County.

Lower mortgage rates in June 2002 (6.65%) pushed the monthly principal and interest payment for the average-priced Baltimore County home, financed with a 30-year conventional mortgage loan, and a 10% down payment, down by 2.1% from a year earlier when the mortgage rate averaged 7.16%. This decline occurred despite a 3.1% increase in the average sale price of an existing Baltimore County home to \$176,500 in June 2002. The median price (the mid-point of all transactions) of an existing home sold in the County in June 2002 was \$140,000, up 9.8% over the June 2001 median. Statewide, the average and median home price increased by 14.5% and 14.4%, respectively, over the June 2001 to June 2002 period. In June 2002, the average price of an existing home sold statewide was \$218,400, 23.7% above the Baltimore County average price.

Property-related transfer tax revenue (recordation and title transfer taxes) will likely decrease by more than 10% in FY 2003, reflecting few housing transactions due to low inventory levels and a slowdown in the refinancing frenzy that occurred over the last few years due to near record low mortgage rates.



CONSTRUCTION

The total value of new construction permits issued in the County in 2002:Q1 was relatively flat from a year earlier.

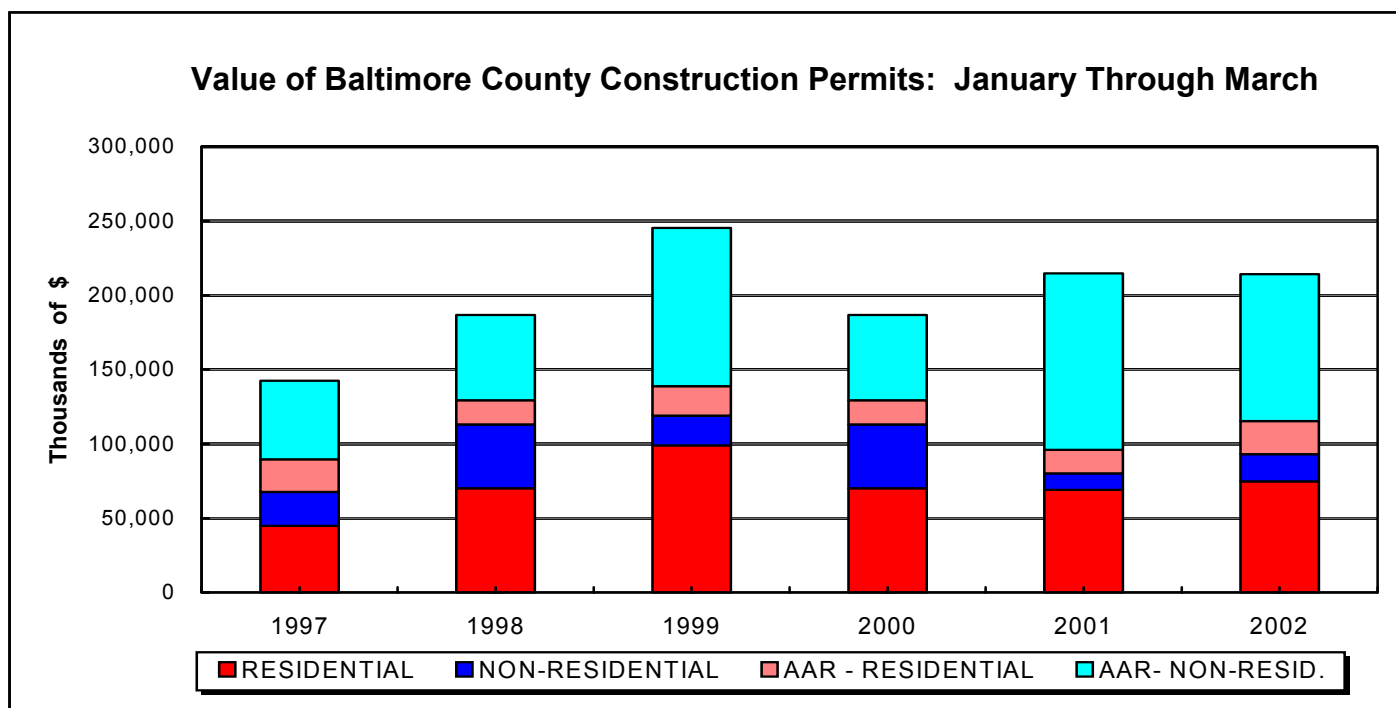
Construction permits issued in Baltimore County in 2002:Q1 totaled \$214.3 million, 0.2% less than in the comparable 2001 period. Despite the small slippage in the combined value of new construction permits (residential, nonresidential, and alterations, additions and repairs) issued in 2002:Q1, the value of those permits was up nearly 15% from 2000:Q1. While certain aspects of new construction are slowing, the overall new construction market still appears relatively healthy and continues to make a positive contribution to the County's property tax base.

New non-residential building activity, perhaps the most volatile component of new construction, in 2002:Q1 increased by \$7.2 million, or 64.0%, to \$18.3 million compared to the previous year's weak showing. However, 2002:Q1 levels were 57.4% less than in the 2000:Q1 period.

Additions, alterations, and repairs (AAR) activity in 2002:Q1 totaled \$121.3 million, 9.8% below the comparable 2001 period. AAR activity accounted for 57% and 63% of the total value of new construction permits in the County issued in 2002:Q1 and 2001:Q1, respectively, compared to around only 40% in 2000:Q1.

In 2002, the number of residential single-family building permits issued from January through March was at its lowest level in over five years. However, a record 931 permits were issued in the previous quarter, in 2001:Q4.

New residential building permits issued by the County in 2002:Q1 increased by 11.4%, with multi-family unit permits up 124.3% and single-family unit permits declining by 12.7% compared to a year earlier. The value of permits in 2002:Q1 was 8.2% ahead of 2001:Q1. The 454 new single-family residential building permits issued in 2002:Q1 was the lowest level of single family permits issued in the County since 410 permits were issued in 1996:Q4; however, this series can be volatile, as a record 931 permits were issued the previous quarter, in 2001:Q4.



COUNTY GENERAL FUND REVENUE

General Fund Revenue FY 2002 – 2003 (Millions of Dollars)

After increasing by only 0.1% in FY 2002, County General Fund Revenue is expected to grow by less than 1% in FY 2003. At no time in recent history (since FY 1970) has General Fund Revenue displayed such a weak back-to-back performance.

Revenue Source	FY 2002	FY 2003	
		Adopted Budget	Current Estimate
Property Taxes	\$527.1	\$545.3	\$545.0
Income Taxes	433.7	438.9	441.0
Sales & Services Taxes	45.6	45.2	46.5
Recordation Taxes	22.6	17.6	19.0
Title Transfer Taxes	40.3	30.0	35.0
Investment Income	5.3	6.3	6.5
Intergovernmental	73.5	73.9	73.6
All Other	<u>52.6</u>	<u>43.0</u>	<u>43.1</u>
Total Revenue	<u>\$1,200.7</u>	<u>\$1,200.2</u>	<u>\$1,209.7</u>

FY 2002 revenue is estimated at \$1,200.7 million, up 0.1% from FY 2001. This revenue pattern reflects weaker income tax revenue and lower investment income, partly offset by revenue gains from property-related transfers.

FY 2003 General Fund revenue is forecast to grow by only 0.7%, representing the second consecutive year of under 1% growth. Despite the projected slow revenue growth, FY 2003 General Fund revenue is expected to exceed General Fund expenditures.

FY 2002 General Fund revenue is preliminarily estimated at \$1,200.7 million, \$8.8 million below the Adopted Budget and in sharp contrast to the two previous fiscal years when revenue came in well ahead of the Adopted Budget. The weak economy and its impact on personal income and stock market capital gains were principally responsible for FY 2002's revenue shortfall, as income tax revenue was \$29.1 million, or 6.3%, below the Adopted Budget estimate. Higher than expected revenue from property-related transfers (up 13.5%) and the sale of County-owned property partially offset weak income tax and investment revenue.

FY 2003 General Fund revenue is projected to reach \$1,209.7 million, up \$9.0 million, or 0.7%, from FY 2002 totals. The projected increase in FY 2003 revenue reflects expectations that the County's two largest revenue sources will show gains over the previous fiscal year, with property tax revenue projected to increase by \$18 million or 3.4%, and income tax revenue projected to rise by \$7 million or 1.7% over FY 2002. The County's property tax base is projected to expand by just over 4% in FY 2003, according to the Maryland Department of Assessments and Taxation. Additionally, County income tax revenue is likely to rebound slightly, reflecting an improving economic landscape, as the U. S. continues to pull out of its first recession in ten years. FY 2003 revenue from property-related transfers is projected to decline from its strong performance in FY 2002. "Other" revenue is also likely to be considerably lower in FY 2003, reflecting a more normal disposition of County-owned property. If FY 2003 General Fund revenue and expenditures materialize as projected, the total surplus at the end of FY 2003 will reach \$110.3 million, including \$66.7 million in the Revenue Stabilization Reserve Account.

